LAND USE RESEARCH
FOUNDATION OF HAWAII
700 Bishop Street, Ste. 1928
Honolulu, Hawaii 96813
Phone 521-4717
Fax 536-0132

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Honorable Stephanie Aveiro, Executive Director
Housing and Community Development Corporation of Hawaii
677 Queen Street, Suite 300
Honolulu, Hawaii 96813

Ms. Aveiro:

Subject: Report from the Working Group on Creative Financing for Infrastructure Development

Background:

The Governor convened the Affordable Housing Task Force in August 2004 in response to S.C.R. 135, S.D.1. This task force was comprised of approximately 100 stakeholders including representatives from federal, state and county agencies; for-profit and nonprofit developers; bankers; property managers; realtors; social service providers; and housing and homeless advocates. The purpose of this task force was to come up with recommendations and implementation strategies for addressing the affordable housing crisis.

Members of the Affordable Housing Task Force attended a conference with the theme *"Where Our Workers Will Live"* on August 17, 2004. The focus was to find feasible ways to address barriers to the development of affordable housing: (1) the lengthy land use entitlement process; (2) the lack of major off-site infrastructure to support development; and (3) the lack of financing resources to develop affordable housing. Task force members made short (within 2 years) and long-term (up to 6 years) recommendations to address each of the barriers.

Smaller working groups were formed to evaluate and, where appropriate, map out implementation plans for the highest ranked recommendations made by the task force. This report is being submitted by the Working Group on "Creative financing" for infrastructure development. Working Group participants were:

Dean Uchida, Land Use Research Foundation (Chair)
Douglas Haigh, County of Kauai, Department of Public Works
Gilbert Coloma-Agaran, County of Maui, Department of Public Works
Glenn Yasui, State Department of Transportation

Thad Bond, Forest City Hawaii
Carleton Ching, Castle and Cooke Homes Hawaii, Inc.
Jan Takahashi, HCDCH

Approach:

The Working Group reviewed existing infrastructure financing methodologies to assess what alternatives are currently available. The National Association of Home Builders prepared an article entitled "Paying for Growth." It has a listing of the various forms of alternative infrastructure financing and/or service delivery systems being used to date. The article includes a discussion of the following:

- ***1) Competitive Contracting--*** "Competitive contracting" means the process by which classified employees of a department, agency, or institution of higher education compete with businesses, individuals, nonprofit organizations, or other entities for contracts. This process is closely aligned with the common term "managed competition." Under managed competition, the state departments/employees and private firms compete to determine who is the most economic and efficient service provider. With contracting out (also called outsourcing and/or privatization), only private entities are allowed to compete by submitting a proposal or bid;

- ***2) Design/Build/Operate--*** The private partner builds a facility to the specifications agreed to by the public agency, operates the facility for a specified time period under a contract or franchise agreement with the agency, and then transfers the facility to the agency at the end of the specified period of time. In most cases, the private partner will also provide some, or all, of the financing for the facility, so the length of the contract or franchise must be sufficient to enable the private partner to realize a reasonable return on its investment through user charges. At the end of the franchise period, the public partner can assume operating responsibility for the facility, contract the operations to the original franchise holder, or award a new contract or franchise to a new private partner. The BTO model is similar to the BOT model except that the transfer to the public owner takes place at the time that construction is completed, rather than at the end of the franchise period;

- ***3) Asset Sales--*** The sale of public assets to the private sector that then steps in to operate privately the public assets, such as toll roads, airports, or wastewater treatment plants. The proceeds of the sale can be used to finance other infrastructure improvements. While this concept is popular in theory, many statutory impediments, particularly at the federal level, have discouraged its widespread implementation. The primary impediment has surfaced from the 100 percent grant repayment requirement found in the "Uniform Administrative Requirements for Grants and Cooperative Agreements to States and Local Governments," referred to as the Common Rule. Under the Common Rule, once an infrastructure asset is sold to the private sector, state and local governments must repay to the federal government the full amount of any federal grant funds used to construct that asset. Of greatest impact is the provision of the order that allows a state or local government to repay the federal grants on a depreciated basis rather than at the full 100 percent rate. With the change in the repayment requirements, the sale of public infrastructure assets to the private sector has recently begun to take hold. For example, the wastewater treatment plant in Franklin, Ohio, discussed briefly above, was sold to a private company, Wheelabrator-Ohio, during the past year since the depreciated federal grant repayment obligation reduced the municipality's costs of sale and thus enabled the private company and the municipality to negotiate an acceptable sale price. In fact, under the criteria of Executive Order 12,803, the federal grant had depreciated to zero so that the municipality was able to reap approximately $6 million from the sale, which it used to reduce certain debt obligations as well as finance other infrastructure improvements. The private company will undertake the operations of the wastewater treatment plant at rates lower than the municipality had charged for operation;

- ***4) Partnership Schools—***A public school system can negotiate with a developer to build a public school facility, in accordance with designs an standards set by the community or state, and lease the facilities to the school system under a long-term arrangement at a predetermined rent. Whereas the developer/investor would be responsible for the physical structure of the public school, the school system would still operate the school with its own teachers, administrators, curricula, educational guidelines and standards, and other such requirements pertaining to educational process. The lease term would coincide with the term of the tax exempt bonds issued to finance the facility, and that at the end of the lease term, the physical structure automatically become the property of the public school system. This arrangement allows for government to take advantage of the lower costs and quicker site development processes of the private sector, while retaining full policy control. Cost savings are also achieved because the interim private owner can make the facility available for other uses when it is not needed for educational purposes;

- ***5) Bond Banks—***Are state sponsored entities that make local infrastructure projects feasible by providing access to the municipal bond market and direct and indirect financial subsidies to local jurisdictions. Bond banks work by issuing their own debt securities, typically enhanced by some form of state credit support. Bond banks act as conduits, re-lending bond proceeds to local jurisdictions to finance water and sewer, school, transportation, solid waste and economic development projects. By pooling a number of smaller issues and backing them with the state's credit, bond banks reduce the cost of borrowing for local jurisdictions. Smaller issuers often are not rated or have lower credit ratings than other issuers in the municipal bond markets. Small issuers often use bond banks because they provide such jurisdictions with lower cost of capital, in terms of both interest rates and costs of issuance. Bond banks also provide smaller issuers with better market access. They are of particular benefit to jurisdictions with projects that are too small to be sold publicly; the fixed issuance costs would be too great to make it cost effective to go to market alone. Bond banks provide local jurisdictions with technical and administrative expertise with respect to the complexities of debt issuance. Municipal finance authorities in states that do not have bond banks should push for state laws that allow for their creation.

- ***6) Special Districts--*** Special districts operate more like a business enterprise, charging customers for their services. For example, a hospital district charges room fees just to their patients, not the district's other residents. Water districts charge water rates to their customers. Virtually all water, waste and hospital districts are enterprise districts. Non-enterprise districts provide services that don't lend themselves to fees because they benefit the entire community, not just certain residents. These districts provide services like parks, police and fire protection, pest abatement, libraries, and cemeteries and rely overwhelmingly on property taxes to fund their operating budgets. Although some non-enterprise districts like parks and libraries may charge fees for some services, these fees generate very little revenue. Additionally, both enterprise and non-enterprise districts can issue either general obligation or revenue bonds to help pay for capital improvements;

- ***7) Community Development Authorities—***CDA's are special taxing districts that allow developers to issue tax-exempt debt to fund infrastructure improvements. In turn, property owners within the district pay an amount in addition to the property tax to service the debt. In effect, the developer-created district performs a quasi-governmental function in co-operation with local government. The CDA concept offers lower cost tax-exempt borrowing, and obviates the need to add infrastructure cost and/or impact fees into the price of the house. A Mello-Roos District is an area where a special tax is imposed on those real property owners within a Community Facilities District. This district has chosen to seek public financing through the sale of bonds for the purpose of financing certain public improvements and services. These services may include streets, water, sewage and drainage, electricity, infrastructure, schools, parks and police protection to newly developing areas. The tax you pay is used to make the payments of principal and interest on the bonds. Your taxes may be paying for both services and facilities. The services may be financed only to the extent of new growth, and services include: Police protection, fire protection, ambulance and paramedic services, recreation program services, library services, the operation and maintenance of parks, parkways and open space, museums, cultural facilities, flood and storm protection, and services for the removal of any threatening hazardous substance. Facilities which may be financed under the Act include: Property with an estimated useful life of five years or longer, parks, recreation facilities, parkway facilities, open-space facilities, elementary and secondary school sites and structures, libraries, child care facilities, natural gas pipeline facilities, telephone lines, facilities to transmit and distribute electrical energy, cable television lines, and others;

- ***8) Small Scale Water and Wastewater Systems—***Recent technological changes in water supply and treatment are allowing residential development, including projects with as few as 100 houses, to go forward independent of existing public treatment services. Several private water companies can provide and operate cost effective water treatment facilities for developments of between 100 and 1,000 housing units. The developer/builder finances the construction of the small-scale facility, and sells the investment incrementally to the utility provider as new housing units are connected to the system;

- ***9) Special Purpose Corporations—***A not for profit entity can be established for any lawful purpose other than for pecuniary profit. Not for profit's are regulated by state tax authorities with respect to their state tax exemptions, and by the IRS with respect to their federal income tax exemption. A Not for profit entity may qualify to issue tax-exempt debt if it meets certain IRS requirements. A special purpose Not for Profit can be an important funding source under which a private developer builds and operates a project for a specified period of time, after which ownership reverts back to the government unit. The corporation can issue tax-exempt bonds backed by revenue sources such as tolls, regular lease payments from government units, tax revenues, or a combination of sources;

- ***10) Tax Increment Financing—*** Tax increment financing funds projects through the issuance of bonds that pay for acquisition, demolition, and infrastructure costs associated with redevelopment. In theory, the process is straightforward. A municipal development authority sees a blighted area in which development could occur given enough preparation, such as sewage or sidewalk upgrades, or construction of a parking garage. The local government bodies that draw taxes from the blighted area agree to the development, a TIF district is drawn around the area, and its property tax base is frozen. The taxes on this frozen base continue to go to the local governments covering the district for a specified time. The authority then sells bonds to fund the improvements. A private developer, enticed by the improved infrastructure, builds an office building or other commercial or residential structures. The property tax revenues on the blighted land that were flat or declining now increase. This rise, or tax increment, is captured by the municipal development authority and set aside to retire the bonds that funded the improvements. Once the bonds are retired, the higher taxes revert to the city, county, school board, and any other taxing body that covers the district.

- ***11) Impact Fees--***Generally speaking, "impact fees" are financial contributions (i.e., money, land, etc.) imposed by communities on developers or builders to pay for capital improvements within the community which are necessary to service/accommodate the new development. Impact fees, however, must be reasonable. To ensure fairness, impact fees can only be assessed (1) for capital improvements that are a direct consequence of the new development and (2) in an amount not exceed an the proportionate share required to serve the new development. In other words, a developer cannot be required to pay a disproportionate share of improvements that also benefit other persons (i.e., a bridge on the other side of town);

- ***12) Road Pricing--***Road Pricing means that motorists pay directly for driving on a particular roadway. Value Pricing is a marketing term which emphasizes that road pricing can directly benefit motorists through reduced congestion or improved roadways. Economists have long advocated Road Pricing as an efficient and equitable way to pay roadway costs and encourage more efficient transportation. Road Pricing has two general objectives: revenue generation and congestion management.

Working Group: Defining Infrastructure

In order to focus the effort of the group, we began by defining "infrastructure" for the purpose of this working group. The following list is what was agreed upon as Public Infrastructure.

1. Roads
2. Water (source, transmission, storage)
3. Sewer (treatment, transmission)

4. Drainage
5. Solid waste
6. Public facilities (schools, parks)
7. Utility corridors

Note: Infrastructure needs and financing opportunities are different for a master planned type of development on raw land and an infill or redevelopment project due to the magnitude of units, size of development and its effects on regional and neighborhood capacities, and subsequent infrastructural requirements. Financing programs need to be tailored for the particular circumstances.

Identify Existing Funding Mechanisms Used in Hawaii

County Funding Process: Counties use basically the following methods: 1) Federal funds (which generally require a local match); 2) State and county Capital Improvement Program (CIP) appropriations funded through general obligation or revenue bonds; 3) Developer impact fees, and developer exactions are generally utilized to fund infrastructure projects; and 4) User fees such as sewer and water fees. Due to the policy on limiting the amount of bond debt, some CIP projects are funded with cash, either from the general fund, property taxes, or a special fund (i.e., fuel taxes, licensing fees, or user fees such as sewer or water.

The County of Maui may float up to $18 million in revenue bonds each year for infrastructure improvements. However, that is not sufficient to meet all infrastructure needs. A new landfill, for example, is estimated to cost from $10 million to $20 million. On Kauai, a new landfill would drain the county's CIP capacity. In the Ewa region of Oahu, developer impact fees at 20% will help fund 5 regional transportation projects.

The County of Kauai used Community Development Block Grants {CDBG} and Disaster CDBG funds to support well development, water mains and storage tanks for water infrastructure. These funds were also used for street lights and turning lanes required by DOT for projects sponsored by the County of Kauai, and ADA renovations at public facilities.

State Highways Process: The Federal Authorization Act normally spans 6 years. The State Department of Transportation (DOT) prepares a 3-year statewide plan for constrained projects and another 3-year plan for unconstrained projects. DOT is looking to shift priority to maintenance from CIP. Unless there is an existing transportation project in the works, an affordable housing project will not be included in the State Highway System

Identification of the Problem

In the 1970s, the federal government paid for the development of major off-site infrastructure such as wastewater plants. The level of federal funding has substantially decreased. Today, the State is fortunate to maintain existing levels of federal funding. In the future, it will be more difficult. In the late 1980s, the State Legislature created the Homes Revolving Fund (HRF) to finance major off-site infrastructure in master planned communities sponsored by the Housing Finance and Development Corporation. The HRF was recently repealed following years of legislative raids to balance the State budget.

There are varying State and county departmental priorities and therefore in the case of affordable housing, coordinating highway and road improvements to specifically address affordable housing needs may not be a priority in light of regional highway and/or county road improvements that are prioritized to meet departmental requirements and standards (i.e. health and safety, etc.).

There is also a lack of a statewide Affordable Housing advocate to coordinate and seek cooperation form various levels of government to address affordable housing. Perhaps HCDCH has to resume the role of an Affordable Housing developer (like in the past) and/or take an active lead in implementing Affordable Housing programs with (or without) private partnership to insure there are constant affordable product being providing regardless of market conditions (do it in good and bad economic times)

Developers of worker housing projects may obtain expedited state and county land use and zoning approvals, as well as waivers from subdivision and building codes under Chapter 201G, Hawaii Revised Statutes. The intent is to reduce costs to reach the affordable target but many times there are inherent conflicts between the 201G waivers and county operating and maintenance. Though subdivision design of this type still must meet basic health and safety, counties are left with maintaining less than standard subdivision improvement. **First Time Affordable homebuyers need to understand that the subdivision processed under Chapter 201G is "substandard" due to waivers approved by the counties.** Additionally, since waivers or exemptions are discretionary, there are liability issues that arise with "substandard" subdivisions.

Under HRS Chapter 201G, a developer processes an application either through the State or the county housing agency.-- During the initial application review stage, while county agencies might provide comments on the proposed waivers, HCDCH or the county housing agency may allow the waiver request to go forward for approval by a County Council even though a particular county agency raised concerns about the proposed waiver of standards. Whether processed through HCDCH or the county housing agency, a 201G project requires a County Council to approve.

Unless the application also discloses that the developer intends to dedicate the improvements to give the County Council notice of the implication of agreeing to the waiver of County standards, the infrastructure would remain private and the homeowners association or the developer would be responsible for maintenance. We understand that the County's Attorneys have opined that State law requires the County to accept roadway dedications without imposing conditions when the improvements meet County standards (underground utilities -- drainage and sewer -- generally are accepted if those facilities are in the roads). In theory, the County Council could separately accept dedication of the infrastructure, with or without conditions, despite being substandard separately from the 201G approval process.

**Note that there is a policy concern with imposing maintenance costs on a project with a large number of affordable units due to the ongoing costs -- homeowners who qualify for affordable units may not be in the best position to be paying maintenance costs (i.e., pump stations, private sewer treatment plants, etc.).

Another issue may be the increased demand for "concurrent development" of public infrastructure in advance of growth and urban demand. Some "smart growth advocates" tout this principle as sensible as compared to the existing process which involves planning (i.e. 5, 10, 20 year plans) and implementing infrastructure according to priorities, demand and available funding. Advancing infrastructure construction in advance of housing construction means increasing up-front funding, which may neither be practical nor feasibility for the promotion of affordable housing.

IV. Alternatives Identified

The following were tools identified in building a toolbox of alternatives:

Leveraging Existing Resources

Project Specific:

- Using existing funding and make infrastructure for affordable housing a priority

Broad based:

- Create county design standards for "workforce housing." An example would be a resort road standard created for Hualalai. These are not "substandard" developments but developments build for a defined outcome.
- Government advocate for affordable housing at the county level—Political Will (addresses home rule issue).

Potential New Resources

Project Specific:

- Developer exactions
- Impact fees (regional)
- Tax increment financing (There is state enabling legislation; each county may have different requirements.)
- Community improvement districts
- Infrastructure Bonds (?)
- Private Foundation Donation/Contribution (i.e. Weinberg Foundation)

Broad Based:

- Broad-based tax increase (e.g., Atlanta sales tax) to provide a dedicated funding source to finance infrastructure
- General excise tax exemptions or tax credits for affordable housing to lower overall development costs. Tax credits or tax incentives to build FOR sale affordable units (not be confused with tax incentives or credits for affordable rental development). Is there a method like the one used for High Tech, Act 221?
- Government revolving fund dedicated to finance affordable housing development (i.e., Dwelling Unit Revolving Fund {DURF} and the Homes Revolving Fund {HRF}; restore it!)
- Impact Fees (Statewide: Schools, Highways, regional county roads, bike paths, parks, other public facility applications?)

Conclusions and Recommendations

The alternatives were grouped into actions that would require no money and actions that would require new money obtained through the use of one or more of the "tools" identified. Before any type of prioritization can be done, policy makers need to narrow the parameters of this effort by providing some guidance on what alternatives would be realistically considered. After the policy decisions are made, the appropriate tools can be further refined and implemented.

Finally, the lack of federal funding has shifted more and more of the cost for infrastructure to the State and Local Government. The state and counties are not only faced with the need to finance the maintenance and repair of *existing* infrastructure; but must also find resources to pay for new infrastructure. Most of the alternative methods of financing infrastructure have been around, and other localities have been using them with limited success. The problem in Hawaii right now is that there is ***no political will*** to increase government spending levels to meet all infrastructure needs for worker housing. The financial support necessary to address the affordable/worker housing crisis can only be obtained through a bi-partisan commitment from the State and County Administrations, and the Legislature to use one or more of the alternative "Tools" identified.

Should you have any questions regarding this report, please feel free to contact me at 521-4717 or e-mail at duchida@lurf.org.

Respectfully submitted,

Dean Uchida, Chair
Creative Infrastructure Financing Working Group